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Summary

11. (SBU) The CFO of Pemex, the Mexican oil parastatal, Juan Jose Suarez Coppel painted a rosy picture of the chances for passage of a bill that will allow the firm to operate more autonomously from the government. The proposal would replace most government secretaries and union bosses on the board with energy and finance experts; allow the firm to derogate from government procurement rules; and issue quasi shares to the public. He called the move necessary to ensure that the oil company would be able to undertake the next generation of exploration and production projects, which he termed essential to ensure that Mexico replaces reserves. Pemex executives have decided to work with the opposition Party for the Democratic Revolution (PRD) to pass the legislation, perhaps in expectation of a win by presidential front-runner Andres Manuel Lopez Obrador.

Pemex Problems

12. (SBU) Econoff and Econ Mincouns met February 27 with Juan Jose Suarez Coppel, Chief Financial Officer of Pemex. Never one to sugar coat, Suarez Coppel admitted that the real obstacles keeping Pemex's reserve replacement rate at only 18 percent last year was its inability to retain significant earnings, as well as its crushing overhead. Still, he added, "if Exxon had our prospects and our exploration budget, they would be able to replace all of the reserves we produced. We lack the experience and the ability. Unless we are allowed to behave as a company, we will never gain those skills."

13. (SBU) According to many of our sources (ref A), the company has been worried about its reserve picture. Its flagship field, Cantarell, will likely begin its decline this year. Suarez Coppel confirmed that the company had been worried about Cantarell since 2003; nonetheless, management was "comfortable" with the Pemex Exploration and Production prediction of a decline rate for the complex just below 10 percent per year. The current management team had committed to stabilize national production over the Fox's term, and Suarez Coppel believed they had succeeded. Production from the Ku-Maloob-Zaap complex would allow Pemex to maintain

crude production volumes through 2010, but beyond that, the forecast was murkier.

¶4. (SBU) Beyond 2010, Pemex would have to develop the Chicontepec field; gain increased profitable production from mature fields; and begin to produce from fields in the deep Gulf of Mexico. Success from these three ventures was far from assured. Pemex's new fiscal regime governing the way the firm returned revenues to the state (ref B) was a necessary step, but additional autonomy, especially in the way the firm contracted, would be essential to the success of the three projects. This was the essential thrust of the corporate governance reforms currently under discussion in the Mexican Congress.

Legislative Proposal

¶5. (SBU) Institutional Revolutionary Party (PRI) Senator Genaro Borrego had proposed Pemex corporate governance reform for the first time in December 2002; the proposal eventually died. A multiparty group is now trying to get the proposal restarted in Congress.

¶6. (SBU) Suarez Coppel, a National Action Party (PAN) supporter, admitted that he was talking to PRD members of Congress to try to get the proposal approved. The PRD deputies feel that AMLO himself should present the plan to send the signal that he was pro-institutions (like Pemex), though this was unlikely.

¶7. (SBU) According to Suarez Coppel, the most recent proposal would have the Presidency select eight Pemex board members for Senate approval. That board would then present

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to the President a proposal for a Chief Operating Officer. The President would either approve or not. Every year, the board would go either to the Senate or to the Chamber of Deputies (probably to the Chamber of Deputies) to present Pemex results and plans. According to other sources to whom we have spoken (septel) the board numbers are far from fixed.

¶8. (SBU) If the law passes, it would go into effect on December 1. Suarez Coppel believed that this should be acceptable. He reported that PRD officials close to AMLO supported the idea. He claimed it had a "good chance" of passing. In the past, Suarez Coppel noted it had been possible to work only with the PRI, but Pemex felt the reforms needed a broader base of support. Bluntly, he noted that as Mexico moved closer to elections, the PAN's ability to affect change declined. He did not want important Pemex reforms to hinge on a "lame duck" so he began talks with PRD Energy Committee Secretary Francisco Carrillo (the highest-ranking PRD member on the Committee). Carrillo was also chair of the SME, the union of Mexico City power company Luz y Fuerza (LyF). (Our follow up discussion with Carrillo is reported septel.)

¶9. (SBU) The most problematic aspects of the new proposal are the introduction of independent board members and the quasi-shares Pemex proposes to issue. The make-up of the Pemex board now includes six members chosen by the executive branch and five chosen by the union. Under one of the current proposals, the government and the union would each choose two representatives with the remaining representatives to be selected by some combination of the Administration and Congress based on their qualifications in energy and finance rather than political affiliations.

¶10. (SBU) Suarez Coppel called the quasi share offering a carrot to offer workers to dilute the strength of Pemex unions. The Government would grant Pemex employees a pension made up of the shares in exchange for union seats on the board, thus tying the workers more closely to the success of the enterprise while diluting the union's strength.

¶11. (SBU) Additionally, the reform would depoliticize the board. The current board, stacked with union representatives, simply cannot pass the cost and staff-cutting measures required to make Pemex operate as a traditional oil company. The stock offering for board seats quid pro quo would allow Pemex to move forward as a functional organization.

Next Phase

¶12. (SBU) If and when the current set of reforms passes, the GOM's next goal will be to create a regulatory body to govern energy development nationally, much as the Norway's Petroleum Directorate and Brazil's National Petroleum Agency do. The creation of such an independent regulator would separate Pemex management from the political aims of the Energy Secretariat, and would create an apolitical body more able to

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withstand political pressure over Pemex. Creating the independent oversight body, Suarez Coppel claimed, will also allow the government to create a greater source of "in-house" expertise devoted to the oversight of the oil company. The oversight body would also provide their expertise to the congress to assist in the democratic oversight of the oil producer.

¶13. (SBU) Suarez Coppel confided that with a functioning independent overseer, the mechanisms would be in place to allow other entities to begin to develop hydrocarbon resources in Mexico. The body would also serve as an independent authority that would enable Mexico to create the regulations to bring this about.

Pessimistic About Fox's Central American Initiative

¶14. (SBU) We asked Suarez Coppel how Pemex felt about President Fox's Mesoamerican Energy Integration Initiative (PIEM). He was dismissive of the project predicting that it would not survive long beyond the December 1 government change. At Los Pinos' request, Pemex engineers had looked at the refinery project. He noted that they estimated the cost of the Central American refinery at USD 4 billion and gave it

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a rate of return of slightly less than five percent, making the project, he claimed, extremely unattractive.

Comment

¶15. (SBU) While Suarez Coppel was a real cheerleader for the corporate governance reform, pre election realities could easily overtake his plans. Nonetheless, his optimism over the reform of the Pemex fiscal regime was justified, as it passed only a few weeks after he predicted it would. Perhaps most telling was the decision by the largely PAN-affiliated management of Pemex to work through PRD deputies to introduce the corporate governance reforms -- an indication that Pemex managers can place practicality over politics.

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